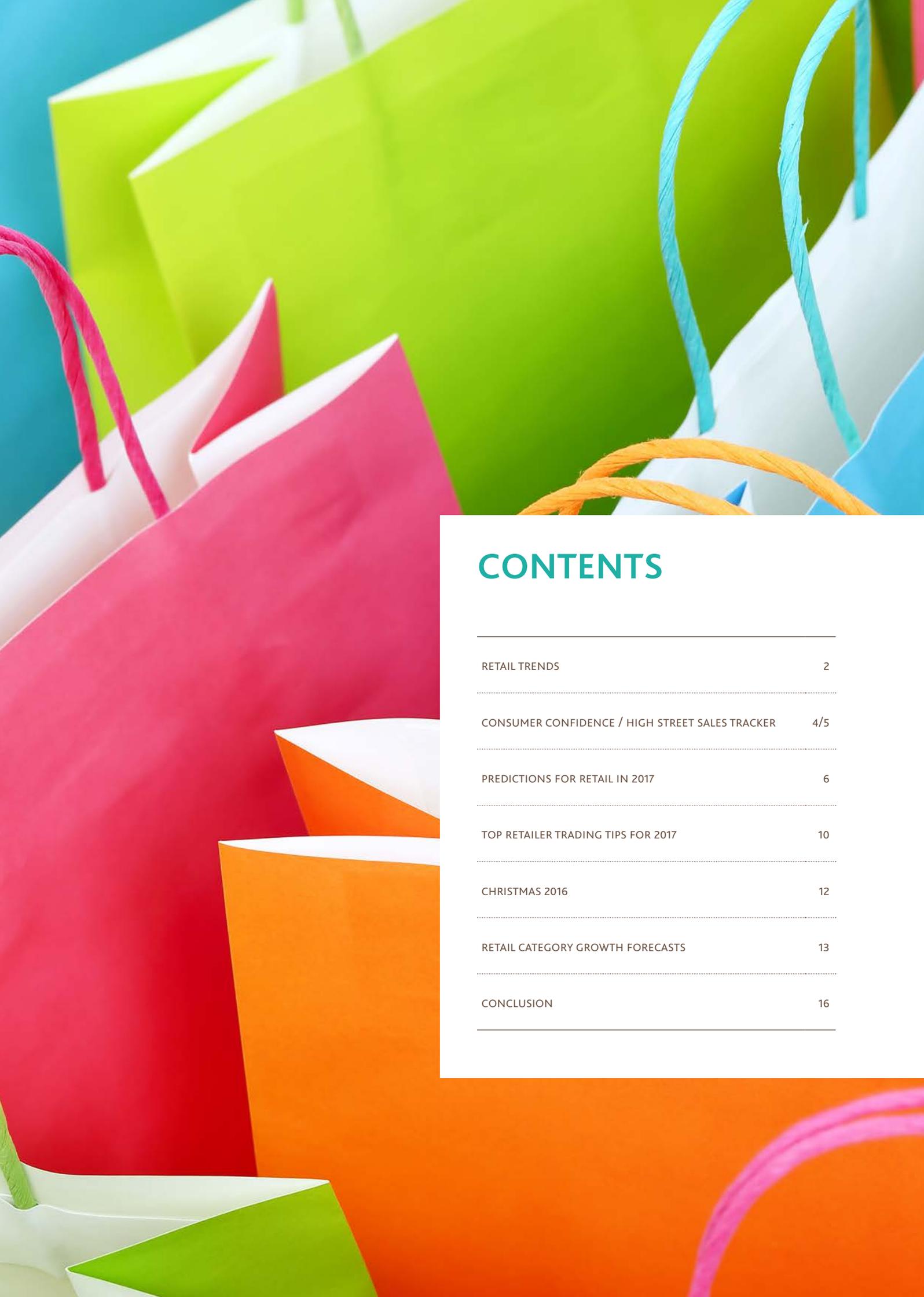




RETAIL AND WHOLESALE

BDO RETAIL FORECASTS 2017

Trading through uncertainty and competition for the consumer purse



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2016 began with a positive outlook for consumer spending; the economic climate continued to improve, interest rates were low, real wages were on the rise and unemployment fell, leading to the conclusion that retailers would be well placed to take advantage of the prospect of looser wallets in the coming months.

In reality, uncertainty has been the prevailing factor in 2016, brought about by the plunge in commodity prices, the UK's decision to exit the European Union in June, and rising costs to retailers as a result of the National Living Wage and the further increases in operating costs. This theme looks to continue into 2017 with the significant fall in the value of sterling, the introduction of the Apprenticeship Levy, hikes in property rates and the relatively unknown impacts both of triggering Article 50 and the result of the US presidential election on international trade.

Outside of the political and economic climate, the sector faces a number of other, long term factors that continue to challenge retailers. Consumer shopping patterns, driven by technological advances, are changing at pace, as are the wider impacts of online through rising costs of fulfilment, added to the inherent cost of discounting. Reports have shown that the UK consumer is still spending, but retailers face strong competition against restaurants, bars and the leisure industry.

The role of the store and its relationship with online has been a clear focus for retailers in 2016 and will continue to be a priority moving forward. The rapid evolution in shopping habits means that innovation remains high on the agenda. Retailers are considering the consolidation of brands to best utilise space and a greater focus on value added services in store in a bid to challenge online and drive customer loyalty and engagement.

Whilst 2017 is set to be a year that continues to challenge retailers, it is not all doom and gloom. Amidst this time of uncertainty, what is clear is that retailers, more than ever, should be focussing on being proactive and agile. Those who act now to ensure a flexible supply chain, innovative channels to market and a focus on product are more likely to weather the storm on the high street.

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RETAIL TRENDS

While the effects of intense competition in what has become an increasingly demanding retail sector continue to be felt in widespread shop price deflation, today's retailers face a broader challenge than merely keeping up with the competition.

As the pace of change in technology and shopping habits continues to accelerate, retailers are faced with catering to a consumer who demands to be able to shop in ever more varied ways and expects an ever more fluid and convenient experience, but does not expect to have to pay extra for the privilege. The resulting fragmentation of the shopping process, combined with the rapid growth of the value sector, has taken its toll on margins.

Added to this, retailers must now bear the costs of the National Living Wage, while rising rents, especially in prime locations, and the burden of business rates, continue to weigh heavily on the sector.

As if that was not enough, the ongoing depreciation of the pound has increased the cost of imports (no small matter for an island nation), putting further pressure on the bottom line. Most retailers have been able to offset the rising costs through currency hedging, but hedging is only a short term solution and tough decisions will have to be made on whether it's commercially feasible to absorb the extra costs or pass them on to the consumer in 2017. With consumers becoming ever more accustomed to searching for the lowest price, the latter option is likely to be unpalatable for many.

Something has to give, and in last year's forecast we predicted that retailers would be forced to pass on some of the rising costs of fulfilment to consumers by, for example, increasing the thresholds for free delivery or free click & collect. Tesco was quick to follow John Lewis's lead by introducing a charge for consumers to click & collect orders on Tesco Direct below £30 in January 2016. While moves such as this are likely to become more commonplace in order to safeguard margins, consumers are unlikely to be amenable to paying these extra costs and with so much choice now available to them, the threat that they may go elsewhere is very real. Perhaps with this in mind, Tesco has since retracted this charge.

IMPACT OF BREXIT

It was a somewhat inauspicious beginning to 2016 on the economic front, with the then Chancellor, George Osborne, warning the economy faced a "dangerous cocktail of new threats". Mr Osborne had been referring to threats from outside the UK, including a plunging oil price and faltering global markets, but in fact, it was to be a decision made by the British people that may well have the most profound implications...

...on consumer finances and sentiment

Consumer confidence remains fragile and took a direct hit following the Brexit vote. While we have yet to see any notable effects on consumer spending, which remains robust, this is set to change going into 2017 as uncertainty rises in the lead up to, and following, the enactment of Article 50.

...on retailers more generally

Between fulfilling the demands of consumers for low prices, speedy and convenient fulfilment and retail theatre, handling the burden of the National Living Wage and absorbing rising import costs, retailers face an ever greater challenge to protect their margins.

...on individual retailer categories

Big ticket products suffered most in the aftermath of 2008, with demand for large scale investment deteriorating. With the housing market again subdued following the substantial decline in volumes in 2008, there is unlikely to be a repeat of this decline, though the pace of the recovery in white goods and furniture may falter over the next two to three years.

BREXIT OPPORTUNITIES WILL EXIST FOR SOME

While the Brexit vote will undoubtedly herald a period of uncertainty, resulting in a tangible impact on specific retail categories, and drive higher inflation, it will present some opportunities for UK retailers. The decline in the value of sterling will make the UK a more attractive shopping destination for overseas customers, providing a particular boost to luxury retailers, in the short term at least.

At the same time, it is also likely to have a knock-on impact on British consumers holidaying abroad, with an expected rise in domestic tourism, and an ensuing boost to coastal towns and large city centre locations being the result.

Brexit is also set to boost those retailers that already source from the UK, both due to the less significant impact of currency fluctuations and the growing consumer demand for the "made in Britain" stamp.

CONTRASTING FORTUNES FOR FASHION AND HOME

2016 was particularly challenging for fashion, which remains on course to have its poorest trading year since 2009. Results at several of the major retailers have disappointed, while high profile administrations have returned in the shape of BHS and Austin Reed.

While many retailers are prioritising investment on online and fulfilment, which is important to stay competitive and provide shoppers with the convenience they demand, it has resulted in some taking their focus off product range and newness. This has left ranges a little lacklustre in 2016 with less style authority, innovation or design credibility – impacting consumers desire to buy into new collections and causing them to extend the lifecycle of their existing wardrobe. In addition to the adverse effects of a poor product range, the vagaries of the British weather, which has seen unusually mild autumns in consecutive years, has once again been cited as a major culprit to a poor performing fashion sector.

In contrast, it was a better year in home, with several of the UK's leading furniture retailers benefitting from the fruits of a resurgent appetite for big ticket spending. That said, with Brexit threatening to usher in a prolonged period of uncertainty, big ticket items like furniture and white goods could be at the mercy of a less confident consumer in the months to come, subduing future growth.

EVOLVING SPACE EXPANSION STRATEGIES

With so many competing pressures on investment decisions, retailers will inevitably be re-evaluating their fixed cost base, including their store portfolios. The space race among the major grocers is long since finished, while M&S's recent announcement that it is to close 30 UK stores and convert 45 more into food only shops reflects a shift in emphasis from conquering new territories to consolidating existing real estate. The ongoing growth of online, which often offers a more cost-effective way to reach consumers, continues to challenge bricks and mortar.

The pressing need to maximise the efficiency of physical space has even spawned a few large acquisitions of complementary businesses (Sainsbury's/Argos, Dixons, Carphone Warehouse) and encouraged others to experiment with concessions to reach new audiences (e.g. ScS in House of Fraser, Dwell and Sofa Workshop in DFS, and Arcadia concessions in Tesco). Online can hardly be described as a panacea though and is notoriously unprofitable for many retailers, while necessitating significant investments in IT and logistics. This in turn, has created opportunities for those retailers who are best suited away from the online channels. This led to a

new breed of largely bricks and mortar based value retailers over the past decade. Their lower cost base in the absence of a multichannel offer has enabled them to offer market leading prices. Increasingly, local retail destinations support a retail mix geared towards value and convenience, with several of the major discount and value retailers eagerly eyeing up opportunities to take market share.

RETAILERS EYE EXPANSION VIA NEW STORE FORMATS

The rapid evolution of shopping habits is encouraging retailers to be innovative in their approach to store formats. The past few years have seen high street stalwarts such as John Lewis, M&S and Next target out-of-town retail parks with new formats. This has also been against a backdrop of tough conditions on UK high streets and in an attempt to widen reach. More recently we have increasingly seen a movement the opposite way, with traditional big box heavyweights, such as IKEA, DFS and Topps Tiles looking to adopt smaller formats in an attempt to target new shoppers and make themselves more accessible.

ROLE OF STORE CONTINUES TO EVOLVE

A fragmentation of spend across a greater number of channels has necessitated a rethink regarding the optimum shape and size of the modern store portfolio, with a growing awareness that physical stores represent a key differentiator from online pureplay retailers. The rising influence of online, and the multitude of new entrants that it has facilitated across different retail categories, has led to an evolution of the traditional role of the store. Operating a large physical footprint, across a variety of location types, leaves multichannel retailers better positioned to meet consumer demand for convenience.

For many retailers, the role of stores is evolving well beyond just being a transactional channel, with many now being fundamental in driving customer engagement, helping retailers to differentiate from online. In clothing, this has seen expansion being focused towards larger 'brand statement' stores, with these flagship operations acting as brand ambassadors.

GREATER FOCUS ON PRICE RATHER THAN PROMOTIONS

Facing a fickle consumer with a limited tolerance for price increases and a seemingly insatiable appetite for bargains, retailers have not helped themselves by adopting an increasingly crowded promotional calendar, marked by the addition of Black Friday, which has completely altered the pattern of sales at retail's most critical time of year. However, there has been a reversal of this trend, with retailers aiming to wean consumers off promotions and focusing on strengthening range architecture and Everyday Low Prices ("EDLP").

With Christmas 2016 set to be challenging for retailers, particularly those operating in the underperforming categories such as fashion, retailers' promotional resolve is likely to be heavily tested. Nonetheless, the prospect of mounting pressures as we go into 2017 will reaffirm the need to focus on EDLP and range architecture.

CONSUMER CONFIDENCE

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Following a Brexit-induced nadir of -38.0 in June the future sentiment index recovered before falling back once again in September by 6.2 points to -26.3, and by a further 6.6 points to -32.9 in October. The largest contributing factor to October's future sentiment index decline was consumers' perceptions regarding economic outlook, with the economic outlook index fell by 10.1 points as government bodies predict a slowdown in economic growth in 2017.

Brexit has impacted consumer confidence and almost a fifth (29.5%) of UK consumers expect their personal finances to worsen over the next six months. Moreover, the present sentiment index has fallen for the first time in five months though remains positive, indicating that the predicted effects of Brexit are beginning to trickle through to consumer sentiment.

Fewer consumers felt able to afford everyday essentials such as food in October, as price rises in food left consumers spending more on their weekly food bill. Less affluent consumers have been most affected due to smaller disposable incomes; these consumers are spending a higher proportion of their take home pay on essentials.

The inflation index fell by 8.7 points in October, to reach its lowest level since November 2013. 51.7% of consumers expect prices to rise over the next six months, with price rises expected to be highest in supermarket food and fuel. The highly publicised debate between Tesco and Unilever is likely to have brought impending price rises to consumers' attention. In this climate of uncertainty it is those retailers that are nimble and have the flexibility to react quickly to fast-changing consumer sentiment that are most well-placed to prosper.

Verdict consumer confidence chart

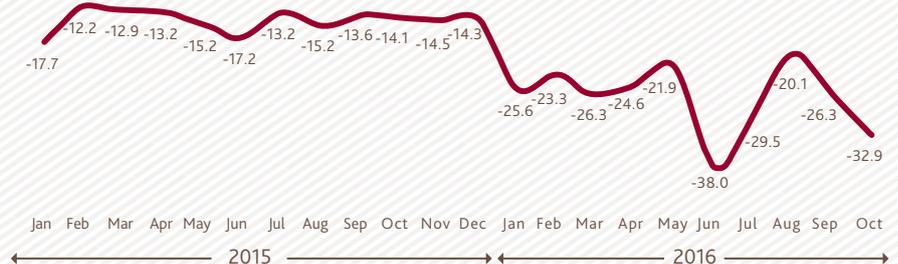
CURRENT INDEX



CHANGE ON... LAST YEAR



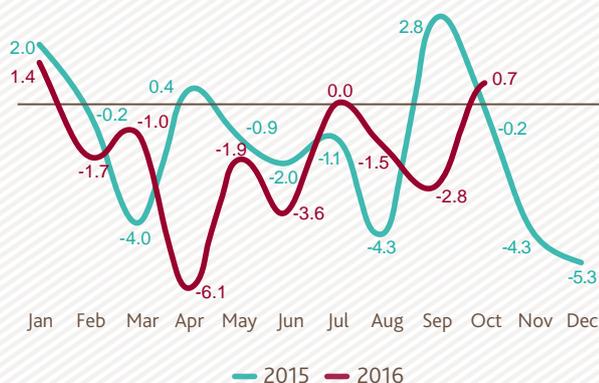
LAST MONTH



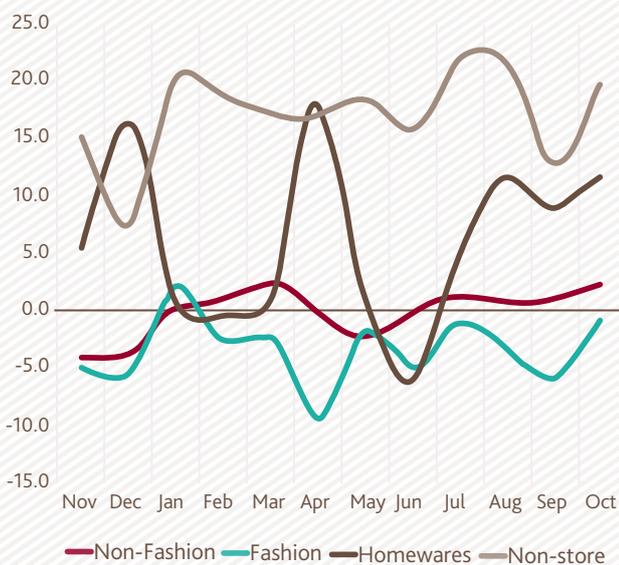
The overall future sentiment index is calculated by averaging out the three main measures of confidence, namely the economic outlook, personal finances, and future retail spending prospects. The average is based on the index for each measure.

HIGH STREET SALES TRACKER

BDO high street sales tracker figures 2015/16



BDO high street sales tracker figures 2015/16



HIGH STREET SALES TRACKER COMMENTARY

2015 was a challenging year for the high street, but if retailers were hoping that this year was going to bring some welcome respite, they were to be sorely disappointed, with growth mired in negative territory from February onwards.

The year began on a positive note, with a strong response to the January sales, restoring some optimism after a very lacklustre finish to 2015, with December witnessing the sharpest sales declines of the year (-5.3%). Optimism began to dissipate thereafter though, as some choppy waters lay ahead. Fashion in particular, has had a very challenging year, with unseasonable weather in April, June and September dampening trade. Fashion retailers have not helped themselves in this regard though, with many product ranges failing to hit the mark, leaving consumers inclined to rely on their existing collection, rather than refresh their wardrobes.

Homewares fared comparatively better, with the home market continuing to reap the benefits of a resurgent appetite for big ticket spending and a slightly more buoyant housing market. With growth in real incomes now set to be even more subdued amid higher forecast inflation and a weaker outlook for economic growth, the return to life of the home market may come under threat in the months ahead.

With a number of retailers conducting a review of their store portfolios, the omens for underperforming high street locations are not good. While food and beverage operators continue to see opportunities for growth, retail looks increasingly likely to settle for second place in the high street hierarchy.

Despite all the doom and gloom, opportunities still remain, driven by retailers that can offer the right mix of value and convenience. The high street is also likely to have an important role in supporting the multichannel journey, with pick-up drop-off (PUDO) points enjoying fast growing popularity. The end of the high street is not nigh, but change may well be afoot.



PREDICTIONS FOR RETAIL IN 2017

RETAIL FACING GROWING BATTLE FOR CONSUMER SPENDING

Retail continues in its long term decline as a proportion of household spending from over half (52.5%) in 1971 to just over a third (36.7%) in 2015. This is a reflection of the increasing affordability of consumer goods, as retailers and manufacturers have devised ever more efficient methods of sourcing, manufacturing and distribution, but also of the spiralling cost of essentials (such as housing, health, education, transport and fuel). More recently, leisure and food service expenditure has experienced resurgence, largely unmatched by the retail sector. For example, in 2015 consumers spent 3.4% more eating out at restaurants, fast food chains and cafes, and also 8.9% more on going to the cinema – compared to expenditure growth of just 1.6% on retail.

RETAILERS PLACE GREATER FOCUS ON VALUE-ADDED SERVICES INSTORE

Linked to the rise in expenditure on leisure and food service, consumer expectations of the physical shopping experience are increasing. As it becomes more important to differentiate from the online shopping experience and as retailers look to bolster the destination status of their stores, there will be a continued focus on introducing innovative and exciting instore services and events. For example, Nike has launched Nike Training Club in its shops and in various parks across London, allowing shoppers to partake in classes ranging from high-intensity workouts, to yoga and training for runners. Elsewhere, Game has announced plans to roll-out 10 instore gaming areas before Christmas 2016. These areas will allow shoppers to pay to use new virtual reality devices as well as entering gaming tournaments.

INSTORE EXPERIENCE IMPROVED FOR SPECIFIC CUSTOMER SEGMENTS

The battle for loyalty is becoming more intense than ever and

emphasising positive brand virtues is increasing in importance in a crowded market. One response has been for retailers to introduce targeted instore services and experience, and we expect this trend to become more pronounced in 2017. For example, Sainsbury's has trialled Slow Shopping periods, with elderly and disabled customers able to use chairs placed at the end of aisles to rest, while also benefitting from extra shop assistants on hand to help with the process. Elsewhere, Toys R Us has trialled a 'quiet hour' aimed at parents and carers of children with autism.

SOCIAL MEDIA INCREASES ITS INFLUENCE AS A MARKETING CHANNEL

Retailers are becoming more adept at utilising social media to drive online engagement and we are increasingly seeing the adoption of more viral and informal approaches. Burberry has been one of the most pro-active fashion brands at attempting to take advantage of the rapid rise in popularity of social network, Snapchat. Immediately prior to the catwalk of the launch of its Spring/Summer 2016 collection, it sent its millions of followers exclusive photos from behind the scenes, driving engagement in the new range.

Elsewhere, Net-a-Porter's Net-Set is a retail social platform which aims to offer inspiration for its customers, in addition to being a transactional channel. Users can create profile, 'love' items and directly purchase products which they like.

NEW APPROACHES TO DRIVING LOYALTY

The deep discounting of the last few years, combined with the growing ability and tendency for consumers to shop around for the lowest price has driven a more fickle consumer mind-set. One response to this has been the growth of subscription services which has been led by the likes of Amazon Prime and Ocado Smartpass, allowing for unlimited and faster fulfilment in return for an annual or monthly cost, in addition to a number of other benefits.

Retailers and foodservice operators are also looking to utilise technology – and in particular mobile – as a way to drive loyalty. Starbucks led the way here with the introduction of an integrated payment, loyalty and marketing app and this year others such as Café Nero and Paperchase have followed in its footsteps in a bid to increase loyalty and maintain market share.

RETAILERS TAKE MORE INNOVATIVE APPROACH TO TRADITIONAL ADVERTISING

Retailers have to rethink their approach to advertising via traditional forms, such as television, with the rise of on-demand services such as Netflix having a significant impact on the effectiveness of this investment. One response has been to focus on shorter television advertisements, with Debenhams choosing this route with its "match made in Debenhams" campaign. Elsewhere, ScS has looked to improve the relevance of its television advertisements, forming a partnership with Sky's AdSmart, allowing it to target different advertisements to different households based on a number of attributes.

While its pre-eminence as a marketing channel is certainly on the wane, television remains an important route through which to drive brand awareness and project brand image and attributes. This is evidenced by pureplay clothing retailers Misguided and Boohoo recently investing in their first television spots.

RETAILERS TO FACE PRICING CONUNDRUM AS INFLATION BEGINS TO BITE

Now that a weaker pound brings with it higher import costs, retailers face a stark choice between continuing to deliver on price and further eroding margin or passing some of this additional cost onto

the consumer. We believe that with limited flexibility left on margin reduction, retailers will be forced to increase prices in 2017, with retail growth over the next two to five years being heavily inflation driven.

DELIVERING THE RIGHT PRODUCT MORE IMPORTANT THAN EVER

A focus on offering the right product is vital given that retailers are going to be forced to increase prices and online continues to represent a growing competitive threat. In discretionary categories, particularly, ensuring that the shopper is presented with an exciting, well curated range can be a key differentiator from the seemingly endless ranges provided online. Linked to this is the potential for product exclusivity to counter the price comparison trend.

LOCAL SOURCING MAY BECOME A BIGGER PRIORITY

The patriotic leanings of British consumers have already led to the "made in Britain" stamp becoming an attractive option for UK retailers and many are already keen to promote their UK sourcing. Going forward, the rise in import costs is likely to make local sourcing a more efficient option as well as a good promotional tool. We expect more retailers to look into bringing their supply chains closer to home.

While this process will undoubtedly take time, such a trend has the potential to bring numerous benefits to retailers, including greater visibility and control over the supply chain, a speedier supply chain, a minimising of the impact of currency fluctuations which are set to be highly unpredictable in the coming years, as well as the potential branding and marketing benefits of "made in Britain".

Online penetration and growth - overall retail

All figures are percentages



Chart shows the total online penetration for each year (total percent of all sales made online).

● Penetration

PREDICTIONS FOR RETAIL IN 2017

CONTINUED

Online penetration and growth - non-food

All figures are percentages



Chart shows the total online penetration for each year (total percent of all sales made online).

● Penetration

RETAILERS TO GET RUTHLESS WITH COSTS

In the current highly competitive trading environment, increasing prices is not a particularly attractive option for most retailers. The rise in import costs comes at a time when margins are already thin, which will likely end up forcing the hand of retailers on this issue. Before it does though, retailers will be doing everything they can to keep prices low. At the same time, it is becoming essential for retailers across the spectrum to focus investment towards ensuring that their propositions remain relevant in the multichannel retail environment. To do this requires expenditure on areas such as new store formats to ensure that store portfolios work in accordance with where and how consumers want to shop; new distribution centres to respond to growing consumer expectations around fulfilment and improve efficiencies; and innovative marketing to communicate and engage more effectively with shoppers.

There is a growing need for retailers to be ruthless in terms of prioritising which areas of the business require investment. This will also require a continuing wider review of driving greater efficiencies, including actions being taken on less profitable stores and a reassessment of staffing structures.

GROWING FOCUS ON THE SUPPLY CHAIN

Retailers have faced significant challenges in responding to growing demand for more timely and flexible fulfilment and a growing fragmentation of the shopping process as consumers are browsing, purchasing and being serviced over a widening array of channels. Customers of today are demanding not only immediate fulfilment but expect the retailers to predict their needs.

In response, retailers are investing in opening new distribution centres to help drive faster and more efficient fulfilment of online orders. Elsewhere, there have been attempts to be more creative in marrying distribution and retail space. For example, DFS has launched a Customer Distribution Centre format (CDC), which turns on-site storage into selling space. Retailers are also looking to partner more with each other in relation to supply chain ownership with Sainsbury's introducing up to 200 click & collect points across its store portfolios, allowing customers to collect Tu clothing, eBay, Argos and DPD orders under one roof.



INCREASING FOCUS ON STORES THAT HAVE A ROLE IN SUPPORTING ONLINE

With the costs associated with the Last Mile (the movement of goods between a transport hub and a delivery address) mounting up, retailers are encouraging shoppers to collect orders rather than have them delivered to home. The challenge is that the existing store infrastructure is often ill equipped to deal with large volumes of parcel deliveries. This is where third party logistics providers come in. While remote lockers have been around for a while and enjoyed mixed success, a new breed of parcel shops is emerging, facilitating easy collection and returns and delivering a more convenient experience for consumers and retailers alike. Meanwhile, retailers themselves are beginning to design stores with the objective of supporting the fast ever growing market for click & collect.

WINNERS AND LOSERS FROM EVOLVING TOURISM TRENDS

The declining value of sterling, combined with falling consumer confidence amid uncertainty around Brexit, will undoubtedly have an impact on the proportion of people holidaying overseas. This will inevitably impact on related products. However, the net impact on UK retail will be positive as more UK consumers embark on staycations. At the same time, the luxury retail segment and significant retail locations such as London will benefit from the increasing attractiveness of the UK as a tourist destination with a falling pound. Lower prices on luxury products are likely to only represent a short term boost however, with retailers gradually adjusting their pricing in accordance to the value of sterling.

RETAILERS MAY LOOK ABROAD FOR GROWTH

With Brexit likely to usher in a period of lower growth and a weaker pound, retailers may try to attract custom from abroad. Major investments in overseas expansion may be off the table for some retailers for the time being, with so much uncertainty around Brexit. One less risky and potentially more cost effective option for UK retailers is to pursue overseas expansion through the launch of foreign websites. Moreover, for those that have already dipped their toe into overseas markets via such websites, the prospect of offsetting potentially weaker UK demand via overseas growth is likely to be attractive. Upping the proportion of revenue in foreign currencies will also be considered to mitigate the impact on margins caused by the volatility in sterling.

BREXIT MAY DETER INTERNATIONAL RETAILERS FROM ENTERING THE UK

A weak sterling is likely to present opportunities for potential overseas suitors of UK retailers. Others though, may be deterred from further investment, given the uncertainties over future trading conditions and the unattractiveness of the exchange rate. Given that trading in the UK already involves burdensome business rates and high rents, many international retailers may think twice before pulling the trigger on UK market entry.

RETAILERS SHOW GREATER PRO-ACTIVITY TO ALLAY GROWING CONCERNS AROUND CYBER SECURITY

Recent high profile cyber security breaches have shone the spotlight on the ability of retailers to protect the personal data of their customers. As a result, we expect consumers to be more aware and vocal about this in 2017, necessitating higher levels of re-assurance from retailers. Moreover there is a growing threat of data leaks having a direct financial impact on retailers, with EU regulations set to lead to substantial fines. In addition to providing a strong customer-facing proposition, it is becoming more crucial than ever that promotional activity is transparent and that customers' privacy respected.

TOP RETAILER TRADING TIPS FOR 2017



LOOK FOR THE OPPORTUNITIES PRESENTED BY BREXIT

While it is certainly set to present some significant challenges for retail and the UK economy more generally, retailers should look to capitalise on the potential opportunities presented by the Brexit vote. The decline in the value of sterling is set to provide a short term boost to luxury retailers, while retailers operating in larger city centres and coastal locations should be prepared for a boost provided by a rise in staycations. Retailers should also take advantage of the growing opportunities presented by the "made in Britain" stamp from both a sourcing and consumer demand perspective.

IDENTIFY OPPORTUNITIES TO LINK UP WITH OTHER RETAILERS

The rise in online continues to necessitate significant investment in IT and logistics, eating into the profitability of retailers. In response, retailers should look to partner more with each other in areas such as supply chain ownership. Taking this one step further, the pressing need to maximise the efficiency of physical space, combined with the significant costs associated with developing a fit-for-purpose modern retail proposition, has led to a recent increase in mergers and acquisitions of complementary businesses; a route that retailers should explore further.

INVEST IN NEW STORE FORMATS TO STAY AHEAD OF EVOLVING SHOPPING HABITS

The rapid evolution of shopping habits means that retailers need to be pro-active and innovative in their approach to store formats. From micro convenience stores offering a dramatically slimmed down range to facilitate a faster experience for the always-on-the-go shopper, to in-store collection points and retailers popping up in non-traditional locations, retailers must ensure they make the most of their physical footprint.

CAPITALISE ON THE PHYSICAL STORE AS A KEY DIFFERENTIATOR

The rising influence of online, and the multitude of new entrants that it has facilitated across different retail categories, has led to an evolution of the traditional role of the store. Retailers should see the role of stores as evolving well beyond that of a transaction channel, appreciating the potential for stores as marketing tools and to drive customer engagement. To this end, the focus should be on statement stores and, where possible, seeking to offer innovative and exciting instore services and events that are aligned to the brand positioning.

BE STRATEGIC AND TARGETED WHEN IT COMES TO PROMOTIONAL ACTIVITY

As trading conditions remain challenging and shoppers tighten their belts, retailers will once again utilise discounts and promotions to ignite spending. However, when it comes to margin eroding discounting, retailers need to strategically seek ways to tailor promotions to different customer groups, product categories or combining promotions with driving loyalty, rather than provide blanket discounts across all products. Retailers' focus must be on helping shoppers justify paying full price – whether it be via quality, customer service, product innovation or design.

SOCIAL MEDIA A KEY ENGAGEMENT TOOL ONLINE

Retailers are becoming more adept at utilising social media to drive online engagement and we are increasingly seeing the adoption of more viral and informal approaches. However, the focus must be on refining their presence; providing engaging content and responsive platforms that offer something different, but are not too intrusive.



PROVIDE A MORE PERSONAL SHOPPING EXPERIENCE TO CREATE LOYALTY

As consumers' shopping habits continue to adopt cross comparison tactics to find the best price, a personalised retail experience should be implemented to entice consumers and build brand loyalty and provide the convenience that many consumers continue to value. Pivotal investment in digital strategies has allowed retailers and brands to gather analytics of consumers browsing and purchase patterns online and via mobile. The utilisation of this data will allow retailers to more effectively tailor home page banners, personalise product suggestions and better describe specific outfit building recommendations. The storing of size data and preferred brands and styles, together with personalised email offers and discounts are methods that must be utilised. However, personalisation also needs to be transcended into stores, ensuring email promotions, for example, are available in-store too.

DO NOT LOSE FOCUS ON PRODUCT

Whilst consumers' discretionary spending is expected to be restricted in the coming years, shoppers' expectations and demand around product and range will increase even further. Margin pressure will force retailers to consider how best to cut costs, but downgrading aspects such as product must not be an option or they risk dissatisfying shoppers who will quickly switch their buying to another retailer. Focus on improving products via enhanced design and quality, and showcasing credentials to shoppers will be crucial across all segments of the market in order to justify the inevitable price rises. Moreover, ensuring that the shopper is presented with an exciting, well curated personalised range can be a key differentiator from the seemingly endless ranges provided online.

TAKE ADVANTAGE OF OVERSEAS OPPORTUNITIES

With UK retail set for a period of more challenging trading conditions, retailers should look to take advantage of potential overseas opportunities. One less risky and potentially more cost effective option for UK retailers is to pursue overseas expansion through the launch of foreign websites. For those that have already dipped their toe into overseas markets via such websites, the prospect of mitigating potentially weaker UK demand through overseas growth is likely to be attractive.

CHRISTMAS 2016

With the noise around the prospect of rising inflation and subdued economic growth, many retailers will be looking forward with trepidation to what may lie in wait in 2017.

With this in mind, opinions are split on whether Christmas 2016 will be the moment when the repercussions of Brexit begin to bite, leaving retailers to fight over what treat spend remains in the market, or whether there will be one final consumer spending splurge before belts begin to tighten in the New Year.

Black Friday has become the new centre piece of the festive trading season and after the Black Friday surge failed to materialise on the high street in 2015, high street retailers have particular cause for concern. Luck played its part in this, with a barrage of winter storms and concerns in the aftermath of the Paris attacks, deterring consumers from venturing out to the shops. Some consumers may also have had in mind the unruly scenes witnessed at several retailers in 2014. Whatever the reasons, online was the clear winner last time around and there is little to suggest things will be different in 2016.

In fact, Black Friday is now something of a misnomer, as many retailers now opt to spread the event over a four day weekend or even one or two weeks, while retaining the "Black Friday" moniker. Having struggled to cope with the logistics of catering to such feverish demand over such a short period, this is a move that makes sense and is backed up by major recruitments of additional

seasonal workers, to ensure there are no hiccups this time around. It is crucial for retailers that their IT and logistics infrastructure does not buckle under the strain as consumers are unlikely to have much patience for websites which crash or deliveries which fail to arrive as promised.

For many retailers, the rise of Black Friday has been an unhelpful development at a time when the focus has shifted towards efforts to encourage more full price sales by, for example, adopting a more targeted approach to promotions. There were signs last year that retailers were beginning to reduce the level of Black Friday discounting and/or making it more focussed on specific categories, with some even announcing that they were omitting this event from their promotional calendar. Taking this path will require a steely resolve and is likely to be impractical for retailers

with a large exposure to key Black Friday categories,

such as electricals. Despite the risks, some

retailers may feel that bold moves are

necessary to protect margins ahead of

what is likely to be a tricky period for

retail. The damage of discounting

on brands is also recognised

but to avoid the necessity

of discounting requires a

strong product and service

offering thereby making

their products highly

desired by their target

customer who will

then be willing to pay

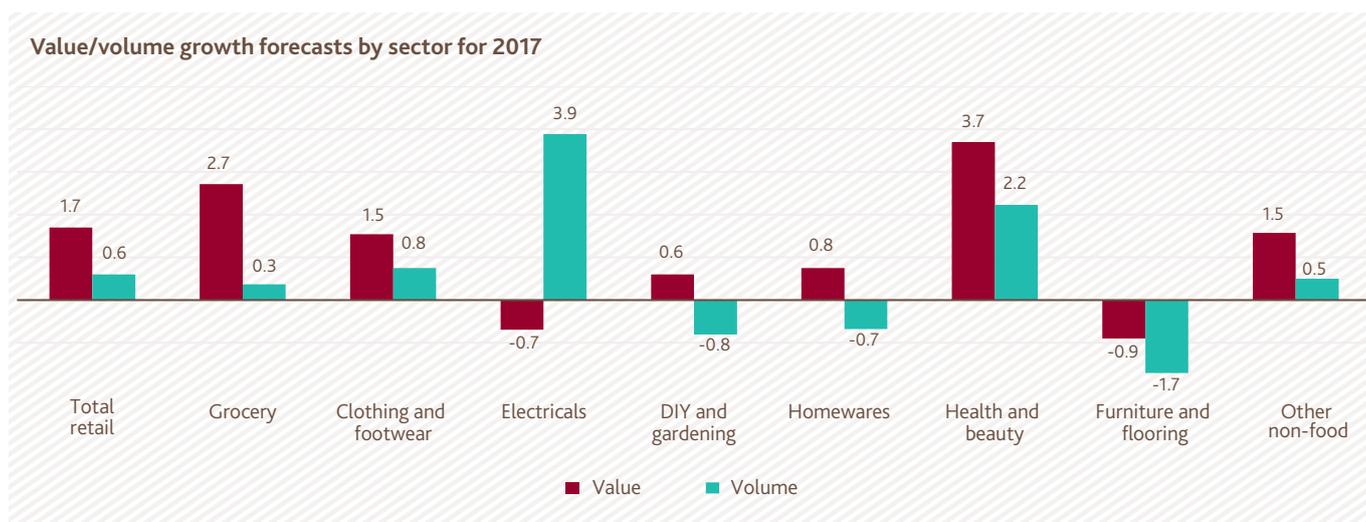
full price to avoid the

disappointment of

being sold out.



RETAIL CATEGORY GROWTH FORECASTS



FOOD & GROCERY

The well-publicised retailer versus supplier skirmish between Tesco and Unilever at the beginning of October is indicative of what is to come both in Q4 and in 2017 in the UK food & grocery market. The past year has seen the major grocery players battling deflation while having to sacrifice profit margin to remain competitive on price.

However, with post-Brexit currency headwinds beginning to bite, price rises are inevitable, albeit slowly whilst retailers tread carefully. This is because with Q4, the 'golden quarter' for food & grocery, all retailers will do everything they can – whether this be battling with suppliers or taking a further hit on margins – to defer raising prices as they seek to win spend over the crucial festive trading period. Many key festive lines will likely have been purchased in advance to guarantee supplies and selling price, however retailers will have to absorb any unexpected cost increases on other products as they seek to ensure that consumer uncertainty doesn't translate into diminished enthusiasm for Christmas food shopping levels.

CLOTHING & FOOTWEAR

At an expected growth of just 1.4% in Q4, 2016 will be the worst performing year for Fashion since 2009 – as retailers have to work harder than ever to drive spend from reluctant shoppers.

With shoppers increasingly immune to discounting tactics, focus will be firmly on the product and retailers to benefit will be those able to communicate value for money via design detail, quality, and through regular newness.

Added to this is the ability to service their customer in a convenient and relevant way personalised for their target market.

The plummeting pound may well provide a bit of Christmas sparkle as tourists take advantage of cheaper premium/luxury goods, which will be a greater benefit to retailers with strong international brand appeal.

While the luxury sector is likely to be boosted by tourist spend, the rest of the market is left to grapple with the challenges posed by a weaker pound – most notably higher costs in the supply chain. Few clothing players will be able to fully absorb increased costs, or risk weakening margins, resulting in price hikes for consumers, damaging volume growth. With pressure piled on small independents, which are less able to withstand margin erosion compared to larger rivals, there is potential for consolidation in the market.

Midmarket players will be able to justify higher prices through investment in style, quality and service; in contrast, price increases at value retailers will be much more evident and remaining competitive on price will be crucial to appeal more to their target customers.

The trading challenges for fashion have long been there to which retailers have responded through their investment strategies with mixed success. The performance gap between those which have chosen the right direction of travel to those which are behind on the journey have and will continue to be ever more prevalent in the short to medium term.

RETAIL CATEGORY GROWTH FORECASTS

CONTINUED

HEALTH & BEAUTY

As one of the most buoyant markets in the face of economic uncertainty and unseasonal weather, health & beauty is forecast to achieve the strongest growth out of all retail sectors in Q4, at 3.8%. Across the pricing spectrum, product exclusives will be key for retailers in the run up to Christmas, helping to boost destination appeal and garner loyalty. While department stores will reign supreme over the premium segment of the market aided by new concession partners such as Charlotte Tilbury and Kat Von D; Boots' performance will be bolstered by the strength of its lifestyle gifting offer, with online fashion pureplay Missguided a new addition to the likes of Ted Baker, Cath Kidston and Superdry, helping to target younger shoppers. Looking forward to 2017, health & beauty is likely to retain its appeal as a low value treat spend, even if the more pessimistic Brexit forecasts come to fruition.

ELECTRICALS

Electricals has been the driver of Christmas sales in past years, but there is nothing in the pipeline at the moment that can match the excitement of previous launches of game consoles, tablets or smartphones, and so we expect electricals retail to underperform the overall market. The latter category suffered the retraction of one of its key products, the Samsung Note, which will make many consumers think twice about being an early adopter of a just-launched product. Google's new challenge to the Apple iPhone, Pixel, has generated a lot of interest, but its high price point may struggle to entice sim-free purchases. The smartwatch revolution appears to have failed miserably, with global shipments collapsing in Q3, but wireless headphones will do well, as will virtual reality headsets, though it may not be till next year that a winning 'must have' product emerges.

HOME

Though protected by the spike in housing transactions in March, this was due mainly to buy-to-let landlords buying property ahead of an increase in stamp duty, and so the boost to home retail sales has already played out. Low levels of housing transactions since then have dampened demand.

With the weakness of the pound threatening to increase prices next year due to the dominance of imported products, consumers planning to make big-ticket purchases may be persuaded to buy sooner rather than later, in order to get the best deal, though many will still delay until the post-Christmas sales.

Having enjoyed something of a return to form over the past two years amid a more buoyant housing market and renewed demand for big ticket products, home has arguably the most to lose from any post-Brexit fallout. More subdued economic growth threatens to de-rail the plans of many home retailers to capitalise on the recent resurgence in demand by investing in ambitious expansion. As the cost of living rises, consumer appetite for replacing furniture and white goods or investing in major home refurbishments may take a hit. That said, there are still likely to be opportunities in homewares to convince shoppers to invest in more piecemeal improvements to spruce up their homes, tiding them over until the circumstances are right for more substantial investments.

ONLINE

We expect online sales to continue to grow much faster than overall retail, with Christmas gift shoppers being increasingly attracted to the convenience of 24 hour shopping. More retailers now offer click & collect and other collection options, and they have also invested in improving delivery services – offering same day and named day delivery as well as narrower time slots, making online shopping more attractive than ever.

CONCLUSION

As 2016 draws to a close, the challenges facing retailers continue to mount in a landscape that is politically, economically and commercially uncertain. Retail has experienced enormous structural changes over the last few years with digital, ecommerce and technology at the heart of transforming the retail landscape in the UK.

The growth and adoption of digital and mobile technologies has caused a fundamental shift in the way consumers shop and interact with retailers, empowering the consumer more than ever. 2016 saw the added significant impact from political movements.

For retail, change continues to be inevitable and in an economy where nothing is more certain than change itself, the focus for retailers must be on product quality, product range and service personalisation to win their share of the tightening consumer purse in a challenging period.

For retailers, Brexit brings with it the unknown, and it is difficult to predict the precise impacts of the enactment of Article 50 on the sector. Given the level of change afoot, it is clear, however, that those business and supply chain models that are setup to provide flexibility and resilience in reaction to external market factors are likely to be in the best position to succeed in the short to medium term.

Retailers should be prepared for the potential challenges and opportunities that the referendum decision presents, such as seeking ways to mitigate the impact of the fall in the value of the pound and attempting to take advantage of the resulting expected rise in foreign spending and looking longer term at what a post Brexit market might look like.

Innovation will also be a key factor in determining the winners and losers in 2017. Retailers shouldn't lose sight of the importance of differentiation and adding value to customers. Omnichannel will remain a focus for those looking to increase brand loyalty and engagement, and the role of bricks and mortar stores will continue to evolve.

Destination shopping will be a key factor for consideration in 2017, where savvy consumers look for an 'experience' as much as they do a product. Retailers might consider how they can utilise the spending environment that restaurants and bars have successfully created to strategically place their stores instead of viewing them as the direct competition for consumer spending.

All in all, 2017 is going to bring about a significant amount of change for the high street. The market is seeing threats from numerous sources and the exact impact of these remain uncertain; so retailers must be prepared. There is going to be a positive correlation between those retailers that are focussed on being agile and able to react quickly to not only address the challenges but also embrace the opportunities that arise, and those retailers who secure profitability and growth over the short to medium term.





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The Retail FD Forum is an exclusive network for FDs and CFOs within the retail industry run by BDO with co-partner, RBS.

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The High Street Sales Tracker is a confidential, weekly exchange of like for like sales between retailers, providing busy retail management teams with accurate performance in a timely manner.

For more information on the Retail FD Forum or the High Street Sales Tracker contact Hannah Scarbrough: hannah.scarbrough@bdo.co.uk

HOW WE CAN HELP YOU

If you would like further information about this publication or our specialist knowledge of the retail sector, please contact:

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